22041

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

ERNEST H. WEIGMAN and BEULA D. WEIGMAN, husband and wife,	)
Appellants,	)
vs.	)
COMMISSIONER OF INTERNAL REVENUE,	)
Appellee.	)

OPENING BRIEF OF APPELLANTS

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BEULA D. WEIGMAN

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STATEMENT OF PLEADINGS AND FACTS TO CONFER JURISDICTION

This is an appeal from a decision entered by the Tax Court of the United States on March 17, 1967, 47 T. C. No. 58.

Appellants had petitioned the Tax Court to review an assessment made by the Director of Internal Revenue.

The Petition appears on page 2 of Transcript of the Record.

The issues involved relate to the application of Sections 165 and 166 of the Internal Revenue Code of the United States as they refer to "trade or business" of a taxpayer.

The Appellants have taken steps required by the Federal Rules of Civil Procedure and the Rules of this Court, and therefore, this Court has jurisdiction to review the Decision of the Tax Court and all other matters in issue.

STATEMENT OF THE CASE

The Appellants, Ernest H. Weigman and Beula D. Weigman, husband and wife, are residents of Pima County, Tucson, Arizona. They were a retired couple for several years preceding 1960. In the summer of 1960 Mr. Weigman made an

investment of $5,000 by the purchase of stock of the Birdcage Restaurant and Cocktail Lounge in Scottsdale, Arizona. At that time, there were two other shareholders, Jerry O'Dell and William Bird.

The corporation had begun business in 1960 with Mr. Bird acting as its President and General Manager. In the fall of 1960 the Appellants were called upon to advance or provide additional monies to the corporation. In the late months of 1960 the Appellants became aware of the fact that Mr. Bird was not managing the corporation in a business like manner and in February and March of 1961 the Appellants performed the following acts:

1. Purchased the interest of William Bird in the corporation and paid him to terminate his management contract.

(Trial Proceedings, p. 14, line 9) (1)

2. Agreed to pay all of the outstanding obligations of the corporation. (Trial Proceedings, p. 18, line 6)

3. Entered into a lease dated March 1, 1961, whereby they personally leased the premises which was occupied by the corporation. (Trial Proceedings, p. 15, line 1)

4. Employed a manager and took active operation and control of the Restaurant business. (Trial Proceedings, p. 15, line 23)

5. Devoted a substantial portion of their time, particularly the time of Mr. Weigman, to the operation and control of said Restaurant. (Trial Proceedings, p. 19, line 9)

6. Continued to lose money and to make payments of the losses. (Trial

(1) "Trial Proceedings" refers to the reporter's record of the trial before the Tax Court.

Proceedings, p. 25, lines 15 to 25)

7. Finally the business came to an end. (Transcript of Proceedings, p. 26, line 8). The evidence indicates that $118,825 was lost after the date of the new lease which was issued on March 1, 1961 to the Weigmans and between January, 1962. (Trial Proceedings, p. 25, lines 15 to 25)

(At all times herein the Weigmans provided their own funds for operation of the business. They continued to place their funds in the corporate bank account and they used the corporate name. (Trial Proceedings, p. 18, lines 10 and 21--p. 27, lines 6 to 11). They had no elections of directors nor of officers). (Trial Proceedings, p. 17, line 12)

The Appellants filed an application with the Internal Revenue Service for a refund for the years 1958, 1959 and 1960,

claiming refunds arising from carry-back deductions for said years. A refund was made and thereafter the Commissioner assessed tax deficiencies for the years 1958, 1959 and 1960, and from these deficiencies the Appellants filed the Petition to the Tax Court (Transcript of Record, p. 2) a Stipulation of Facts was filed with the Tax Court (Transcript of Record, p. 9) evidence was presented thereon by the taxpayer (Trial Proceedings) and a decision was entered by the Tax Court (Transcript of Record, p. 12) wherein a majority of the judges of the Tax Court sustained the Internal Revenue Service but the trial judge, the only judge present at the trial on the issues, dissented.

The refund by the Internal Revenue Service was based on a carry-back loss of $154,825. Part of this occurred when the Weigmans were in an investor

status. Thus, $36,000 is a proper subject of a deficiency assessment. The sum of $118,825 is a business bad debt loss.

The issues presented for appeal are the application of Sections 165 and 166 Internal Revenue Code to the factual situation. The Appellants contend that the loss which they sustained was a business loss and that, though they began as investors in a Restaurant business, they soon became engaged in the trade or business of operating a restaurant and lost their status of investors when they became involved in said trade or business.

SPECIFICATION OF ERRORS

The Tax Court erred in the following particulars:

1. The Tax Court erred in that it

found the Appellants were not engaged in the trade or business of operating a restaurant when the evidence lawfully proved that they were engaged in the trade or business of operating a restaurant.

2. The Tax Court erred when it failed to apply correctly the provisions of Sections 165 and 166 Internal Revenue Code, and to rule that the losses of the Appellants were those incurred in their trade or business.

3. The Tax Court erred when the majority thereof failed to follow the dissenting opinion of the trial judge who was present, heard the evidence and reached a valid and lawful conclusion in his dissenting opinion.

SUMMARY OF ARGUMENT

The Appellants contend that they were engaged in the trade or business

of operating a restaurant. Their position has been that they came into the corporation as shareholders (investors), that the purpose of the corporation ceased in substance, that they soon became the active operators of the business on a personal basis. At that time, they argue, they became involved in the trade or business of operating a restaurant.

The losses ($118,825) which they claim as business losses were those which arose after the Appellants took control of the restaurant as their trade or business. The losses ($36,000) which they sustained as shareholders in the corporation are not claimed in this appeal, nor were they claimed before the Tax Court.

The Appellants further argue that the conclusions of the trial judge of

the Tax Court, who heard the evidence and who dissented from those judges of the Tax Court who did not hear the evidence, should be given great weight by the Court of Appeals.

ARGUMENT AS TO SPECIFICATION OF ERRORS NO. 1 AND NO. 2

The report of Trial Proceedings, pages 14 through 19 in particular, further indicates the intent and acts of the Appellants who changed their status from investor to operator (business). At the beginning of the events, in the summer of 1960, the Appellants assumed no administrative control of the business, but after they purchased the entire business, they devoted all of their time to the business, they assumed complete control thereof and subjected themselves to complete economic liability for the operation

f the business. They entered into a
ew lease on a personal basis and they
aid all past debts of the business and
ll operating debts of the business.

Sections 165 and 166 of the Inter-
al Revenue Code permit one who is
ngaged "in a trade or business" to
educt losses from income, whereas,
fter loss occurs by reason of invest-
ent it may only be deducted in the
anner of short term capital gains.

The issue presented is whether or
ot the Weigmans were engagaged in the
rade or business of operating a res-
aurant or whether they were investors
n a failing corporation.

The Sections of the Internal
evenue Code which are involved are
65 and 166.

"SEC. 165. LOSSES.

(a) GENERAL RULE.--There

shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

(c) LIMITATION OF LOSSES OF INDIVIDUALS.--In the case of an individual, the deduction under subsection (a) shall be limited to--

(1) losses incurred in a trade or business; ..."

"SEC. 166. BAD DEBTS.

(2) NONBUSINESS DEBT DEFINED.--For purposes of paragraph (1), the term 'nonbusiness debt' means a debt other than--

(A) A debt created or acquired in connection with [a trade or business of the taxpayer]."

The position of a taxpayer who seeks to secure business bad debt treatment for monies advanced to a corporation has been the subject of many cases. The courts have held that loans or advances to a corporation for the purpose of maintaining the corporate structure and continuing with the same are not

oans in the "trade or business" of the axpayer, but they are loans made by nvestors and that the investor may ot receive a business bad debt deduction. ypical of these cases is Omaha National ank v. Commission, 183 F2d 899, wherein he taxpayer, an attorney, intentionally ontinued corporate activities during he time monies were advanced to the orporation.

The taxpayers (Weigman) herein ere not seeking to continue the cor- orate structure but were intentionally gnoring the existence of the corpo- ation and were considering their ctivities to be personal. The record ndicates that through ignorance the axpayers used some of the structure of he corporation as matters of con- venience and that they created evidence of "loans" without advice from any

nowledgeable persons. (Trial Pro-
eedings, pp. 31-35.)

Under the facts as adduced at the ime of trial the taxpayers argue that hey are entitled to business bad debt reatment and that they should be per-itted to treat their loss of $118,825 s a debt incurred in their trade or usiness.

Whether money has been expended in taxpayer's trade or business has been eclared to be an issue of fact.

> "Question whether a debt is one the loss from the worthlessness of which is incurred in tax-payer's trade or business is a question of fact in each par-ticular case."
> Pokress v. Com. of Int. Rev., 234 F2d 146.

The most recent pronouncement on he issue of "trade or business" of a axpayer is Whipple v. Com. of Int. Rev., 373 U.S. 193. Therein the Supreme Court

of the United States indicated,

> "Devoting one's time and energies to the affairs of a corporation is not of itself, and without more, a trade or business of the person so engaged."

This concept does not change the expression in Burnet v. Clark, 53 S.Ct. 207, wherein it was stated:

> "The respondent was employed as an officer of the corporation; the business which he conducted for it was not his own. There were other stockholders. And in no sense can the corporation be regarded as his alter ego, or agent ..."

It is to be observed that in both of these landmark cases the taxpayer was intentionally continuing with the corporate structure.

There is a line of cases which has permitted, or at least recognized, the existence of business bad debt treatment to a taxpayer who is operating independently of the corporation. This

ine of cases has permitted business bad
ebt treatment to taxpayers who retained
corporate structure in form but who
perated the business of the corporation
s their independent trade or business.
rimarily these cases are those in which
taxpayer has continued the business of
he corporation but has assumed all
perating debts of the corporation (and
opefully has agreed to accept the
rofits of the corporation.) This line
f cases includes Bryce v. Keith, 257
ed 133:

> Losses on the value of corporate stock were accepted as 'incurred in trade.' The Court stated, 'The transactions by which the decedent became the owner of the stock were carried on over a considerable period, were complicated in character, involved a very large sum of money, and must have required much of her time and attention, and I am of the opinion that they were of the character contemplated by Congress as "incurred in trade".'"

"The agreement between Wiggin and the lumber company made all its operating losses his losses. During these four years, Wiggin was carrying on this lumber business almost exactly as though it had been his own personal business. Its possible profits and its actual losses were his, individually. Under the contracts he managed it, without interference or control by the board of directors. The corporation was merely entitled to an accounting of the operating results of his management; otherwise its corporate business functions were practically suspended. Under these contracts, this lumber business was, in a very real sense, Wiggin's trade and business."
Wiggin v. Com. of Int. Rev., 46 F2d 743.

But where the loss was to a corporation, with no probability of a loss to a taxpayer who had made guarantees, the court refused to ignore the corporate existence. It appears that the evidence in the particular cases precluded any probability of loss to the taxpayer, and upon this fact the

Crcuit Court refused to find a busi-
ness loss. Hickey v. Chahoon, 153 F2d
17.

Maytag v. U.S., 289 F2d 647, states:

> "The advances took the form of loans, negotiable notes being issued for each advance of money. They were recorded on the corporation's books and on the plaintiff's personal books as loans. The debts to the plaintiff were never formally subordinated to those of other creditors, though in fact the plaintiff did not insist on a pro rata distribution with other creditors, because he was so closely identified with the corporation that he did not think it would be honorable to take a part of the small amount available to the creditors."

nd upon such language the Court ruled
hat the plaintiff was entitled to
ecover upon a claim for a refund. A
usiness bad debt had been established.

It is the position of the taxpayers
hat they have ignored the existence
f the corporation. Their independent

ourse of conduct which made the peration of the restaurant their trade or business" is sustained by vidence relating to the personal ease for the property involved, the ayment of all business debts and perating debts from their personal unds, the complete lack of corporate inutes, meetings or elections and of heir continued control of the operation of the restaurant.

Confirming the validity of such a osition is Van Clief v. Helvering, 35 F2d 254, wherein it is stated:

> "There is no reason to apply a different rule because the sole stockholder is an individual. The fact that Van Clief made the advances to keep the corporation afloat rather than to liquidate it, has no tendency to show that a voluntary addition to capital rather than a loan was intended."

The use of the corporate bank

ccount (which the Weigmans allege was
ontinued for convenience), and the
iling of tax returns for 1961 cannot
e ignored. The evidence indicates
Stipulation of Facts, Transcript of
ecord p. 9, sub-page 5) that the tax-
ayers intended to receive tax benefits
rom their losses and that these benefits
ould be received in personal manner.
he taxpayers intended that the corpo-
ation was their alter ego. If this
s so, then under the rules discussed in
urnet v. Clark, supra, the taxpayers
ould be entitled to tax treatment
esulting from their business bad debt
ncurred in their trade or business.

The foregoing cases permit a
axpayer to achieve a business bad
ebt in a situation wherein the tax-
ayer (1) has ignored the substance of
orporate existance and has assumed

ersonal liability for its debts and
ts operation, or (2) has devoted all
is time to the affairs of the cor-
poration. The situation at bar certainly
ollows the foregoing concepts. Mr.
eigman assumed personal financial
iability for the operation of the
usiness (new lease, payment of past
ebts and of operating debts) and
evoted all his time to the operation
f the business. Under the law and the
acts the Weigmans are entitled to be
lassified as having a trade or business
ebt.

ARGUMENT AS TO SPECIFICATION
OF ERROR NO. 3

Traditionally the appellate courts
eek to find support for the actions
nd conclusions of a trial judge.

The presence of the trial judge
t the actual proceedings is recog-

ized as most important for he may observe the witnesses and reach conclusions on a first hand knowledge basis.

Ironically in this trial the Judge who heard the witness and who reviewed the exhibits as presented by the witness reached a conclusion opposite from the judges who read the record.

Such a situation should not be ignored by the Court of Appeals. It is true that this fact alone is certainly no basis for a reversal of the Tax Court, but on the other hand, it is a fact to be given great weight by the Appellate Court.

Respectfully submitted,

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APPENDIX

STIPULATION OF FACTS, admitted as to Petitioners and Respondent

Transcript of Proceedings Page 9
Before The Tax Court of the United States
Phoenix, Arizona
February 1, 1966
Docket No. 3559-64

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

E. F. Rucker